

Review of the Railroad Unemployment Insurance Act Contributions
Report No. 99-14, September 21, 1999

Background

In the early 1980's, the railroad unemployment program experienced severe financial problems because of a recessionary economy and a generally declining railroad labor force. In order to maintain benefit payments, the railroad unemployment system borrowed from the railroad retirement system. On November 11, 1988, the Railroad Unemployment Insurance and Retirement Improvement Act (Improvement Act) was signed into law (Public Law 100-647). It amended the Railroad Unemployment Insurance Act (RUIA) to establish an experience-rated employer contribution system. The intent of the law was to strengthen the financial soundness of the unemployment program and require employers with higher unemployment experience to contribute more to the program. This legislation established a variable tax on each employer's compensation (contribution rate). Previously, each employer paid a flat eight percent contribution rate.

The Improvement Act correlates an employer's basic contribution rate to its experience with respect to the RUIA benefits paid to its employees. Each employer's contribution rate consists of the following components:

--the basic contribution rate,

--an administrative expense rate based on the Railroad Retirement Board's (RRB) cost of administering the RUIA program — .65 percent for fiscal years 1998 and 1999, and

--a pooled credit or a surcharge, depending upon the year-end balance of the Railroad Unemployment Insurance Account (Account).

The pooled credit is a rate reduction that is provided when the Account balance is above a certain level. The surcharge is added to maintain an adequate level of funding for the RUIA program when the Account balance drops below a certain level. These maximum and minimum levels, or trigger amounts, were initially set at \$250 million and \$100 million. The minimum and maximum balance range was intended as a buffer for the Account during times of high unemployment, when more unemployment benefits would be paid out.

Policy and Systems personnel in the RRB's Office of Programs have the primary responsibility for maintaining the experience rating system. The Railroad Experience Rating system (RRXR) contains records of employer contributions, compensation data, benefit payments, and benefit recoveries. RRXR maintains an account balance for each employer representing its contributions less benefit payments. RUIA benefit payment and recovery systems update employers' RRXR records daily with payment and recovery data. RRXR calculates contribution rates based on employers' benefit payment experience.

The Bureau of Fiscal Operations (BFO) maintains the Employer Contribution and

Collection System (ECCS). Each quarter, employers file Form DC-1, Employer's Report of Contributions under the RUIA, and submit their contribution payments to BFO. Contributions owed the RRB are equal to an employer's taxable payroll times its contribution rate. BFO enters the DC-1 payroll and contribution data into ECCS and uploads this data to RRXR.

RRXR prepares quarterly notices to employers after the ECCS update. These notices inform each employer of its cumulative contribution and benefit balances. Annually, RRXR updates system-level data and determines next year's contribution rates for each employer. The Improvement Act requires the RRB to notify each employer of its contribution rate for the next calendar year by October 15. This annual notification must also include the Account balance and other system-level information. Each year, the Bureau of the Actuary reviews RRXR calculations and submits a report to Congress on the financial status of the Account. As of September 30, 1998, the Account balance was approximately \$90.6 million.

Objectives, Scope, and Methodology

The objectives of this review were to determine (1) the accuracy, efficiency, and effectiveness of the calculation of railroad unemployment contribution rates; (2) the timeliness of contribution notices sent to railroad employers; and (3) the timeliness of contribution payments received from railroad employers. To accomplish these objectives, the audit team:

- interviewed Office of Programs, BFO, and Actuary management and staff concerning pertinent procedures;

- reviewed background material, including laws, regulations, legal opinions, policies, and procedures; and

- reviewed the calculation of randomly selected contribution rates and related reports and notices.

This review was designed to help the RRB meet two goals in the RRB's Strategic Plan. One goal of the Strategic Plan is to provide excellent customer service. Two objectives in meeting that goal are to (1) provide relevant, timely, and accurate information which is easy to understand and (2) ensure an efficient and effective reporting system for railroad employers. Another goal is to safeguard trust funds through prudent stewardship. An objective in meeting this goal is to ensure that trust fund assets are projected, collected, and recorded appropriately through an effective and efficient trust fund management program.

The OIG conducted the audit in accordance with generally accepted government auditing standards applicable to the audit objectives. Auditors performed the fieldwork at the RRB headquarters office in Chicago, Illinois from October 1998 through August 1999.

Results of Review

Our review determined that the RRB should improve controls to ensure the accuracy, efficiency and effectiveness of the railroad unemployment contribution system, including the calculation of contribution rates. The RRB is not meeting the intent of the Improvement Act to strengthen the unemployment insurance program and require experience-based contributions. In addition, the RRB is not accurately and efficiently maintaining employer records as mandated by the Act.

The review showed that the RRB is sending the proper contribution notices to employers in a timely manner. The RRB is also receiving contribution payments from employers in a timely manner.

Intent of the Improvement Act

The RRB is not strengthening the financial soundness of the unemployment program or meeting the requirement that employers with higher unemployment experience contribute more to the program. When the RRB instituted the experience rating provisions of the Improvement Act on January 1, 1990, the Account had a balance of approximately \$138 million. This beginning balance would have functioned as a buffer within the Account. On June 29, 1993, the RRB transferred \$180 million from the unemployment system to the retirement system to repay a loan. The transfer was not factored into the experience rating calculation and, therefore, eliminated the buffer.

After a transition period, the RRB fully implemented experience rating during the last two quarters of fiscal year 1993. The table below shows that the Account balance began to steadily decline after fiscal year 1993.

**Status of the Railroad Unemployment Insurance Account
(In millions of dollars)**

	FY1993	FY1994	FY1995	FY1996	FY1997	FY1998
Employer Contributions	\$ 28.5	\$10.4	\$ 6.2	\$ 6.8	\$ 12.9	\$ 67.5
Benefit Payments	\$ 69.9	\$ 66.7	\$ 60.4	\$ 63.4	\$ 71.5	\$ 59.2
Account Balances	\$258.7	\$217	\$174	\$128.1	\$ 75.7	\$ 90.6

As of June 30, 1997, the Account balance dropped below the \$100 million minimum. Because of this drop, employers were required to pay a surcharge of 1.5 percent for calendar year 1998. Provisions in the Improvement Act automatically triggered this

surcharge. Employers will continue to pay the surcharge based on their calendar year 1999 taxable payrolls. Even under its most favorable economic and employment assumptions, the RRB anticipates surcharges for seven of the next eleven calendar years.

System Unallocated Charge

One element of the experience rating calculation is a system unallocated charge. This component is comprised of charges and income to the Account that cannot be assigned to individual employers. The calculation provides for apportioning of the system unallocated charge balance to employers. Employers with larger payrolls get a larger share of the system unallocated charge balance.

Since 1990, annual unallocated income to the Account has exceeded annual unallocated charges, resulting in a negative system unallocated charge balance (credit) every year. The Improvement Act was not clear concerning the distribution of this credit.

Annually, the RRB has apportioned the credit to employer accounts. From 1990 through 1998, the credits totaled \$202 million.

The RRB's distribution of system unallocated credits has shifted the employer contribution system away from being based on experience. It caused this shift in two ways. First, the distribution of the credits canceled out benefit charges on the basis of employer payroll size. Second, distribution of the credits necessitated a surcharge, a flat rate on all employers' payrolls, to stabilize the declining Account balance. The Account balance dropped as contributions did not keep up with benefit charges.

The Basic Contribution Rate

The basic contribution rate established by the Improvement Act is determined by subtracting an employer's reserve ratio from its benefit ratio. The reserve ratio is an employer's account balance (cumulative contributions less benefits paid) divided by its one-year taxable payroll. The benefit ratio is the ratio of the benefits charged to an employer during the previous three years to the employer's taxable payroll during the previous three years.

The reserve ratio may be either positive or negative, depending on whether the employer's account balance is positive or negative. Therefore, the basic contribution formula is designed to ensure that an employer's contributions equal its benefit charges over time. For example, a positive reserve ratio results in a basic contribution rate that is less than the benefit ratio. A negative reserve ratio results in a contribution rate that is greater than the benefit ratio. As a result, the reserve ratio tends to drive an employer's account balance to zero. However, since the Account's \$138 million beginning balance is no longer available to act as a buffer, this action will trigger surcharges as the Account balance drops below \$100 million.

Recommendations:

The Board Members should seek amendments to the RUIA to:

--change the experience rating formula to maintain the Account at the intended minimum balance level (Recommendation 1),

--discontinue the distribution of system unallocated credits to employers' benefit payment histories, which may not require an amendment (Recommendation 2), and/or

--establish a required reserve amount as part of the reserve ratio calculation (Recommendation 3).

Management's Response:

The Chair does not concur with Recommendations 1 and 3 because it appears that a majority of the Board Members would not agree to them. The Office of the Labor Member and the Office of the Management Member informally indicated that the Board Members should not take action to amend the RUIA without the input and agreement of Rail Labor and Rail Management.

The Chair also does not concur with Recommendation 2 because it appears that majority support for a change in interpretation is lacking. Neither the Office of the Labor Member nor the Office of the Management Member indicated an interest in making this change in interpretation. However, the Chair received comments from the RRB General Counsel, who advised that the RUIA may be interpreted as providing only for the distribution of unallocated costs, and not credits, among employers. The General Counsel also advised that if such a change is to be made in the long-standing interpretation, the agency could do so with the rule-making process and provide an opportunity for public comment.

OIG's Response:

The OIG agrees with the General Counsel regarding Recommendation 2 and believes the Board should immediately discontinue the agency's practice of distributing unallocated credits among employers. We also believe that discontinuing this practice is a short-term solution to decline in the RUIA Account balance. For a long-term solution, the Board Members should reconsider Recommendations 1 and 3.

Posting of Employer Contributions

BFO incorrectly posted employer contributions into ECCS and subsequently RRXR. The audit team's reconciliation of quarterly contributions posted in RRXR with BFO's accounting records from 1992 through 1998 found differences in every calendar year. Some of the differences may be due to interest and penalties that are posted in the

accounting records but are not included as employer contributions in RRXR. The following table shows these differences.

Employer Contributions

Calendar Year	BFO Accounting Records	Posted to RRXR/ECCS	Difference	Difference As % of Contribution
1992	\$ 115,760,327	\$ 116,710,195.01	- \$ 949,868.01	- 0.8%
1993	47,217,370	49,020,438.83	- 1,803,068.83	- 3.8%
1994	25,246,638	24,347,805.59	898,832.41	3.6%
1995	22,877,073	23,057,959.74	- 180,886.74	- 0.8%
1996	24,016,591	50,094,551.48	- 26,077,960.48	- 108.6%
1997	29,875,472	30,095,590.36	- 220,118.36	- 0.7%
1998	87,425,810	87,207,683.88	218,126.12	0.2%

The audit team initially asked BFO staff for an explanation for the differences between their accounting records and the postings to RRXR and ECCS. They determined that during the third quarter of calendar year 1996, they posted employer contributions to ECCS and RRXR that were overstated by more than \$27 million. In one case, a contribution was posted as \$25,816,969 rather than the \$258,169.69 that was reported on the employer's Form DC-1. In thirteen other instances, BFO staff incorrectly posted compensation amounts where contributions should have been recorded.

The audit team also noticed that, for one employer, a compensation amount was recorded in RRXR as the contribution amount in the fourth quarter of calendar year 1996. Office of Programs personnel said that this employer actually paid the larger compensation amount, making the entry correct. In November 1996, BFO refunded the overpayment to the employer. Nevertheless, BFO did not correct the contribution amount recorded in ECCS prior to uploading the data to RRXR.

RRB regulations (20 CFR 345.306) require the agency to maintain accurate data in individual employer records for the calculation of RUIA contribution rates. BFO has programmed ECCS with an edit that compares BFO-entered employer contribution amounts with the expected contribution (the compensation times the system-provided contribution rate.) This edit alerts BFO personnel to employers who did not use the proper contribution rate and/or did not pay the proper contributions. ECCS can generate a report identifying the possible data entry discrepancies.

BFO staff did not run this edit report on a consistent basis and did not run it in 1996. In addition, BFO does not reconcile ECCS contribution records to its accounting records.

The incorrect data entry and posting errors have resulted in some erroneous contributions, especially for new employers. (An employer first covered under the RUIA is classified as a new employer; other covered employers are classified as old employers. New employers have special contribution rates for the first three years.) While reviewing these errors, BFO also identified four employers that were incorrectly classified as new employers, and 11 employers incorrectly classified as old employers.

The total impact on 1998 employer contributions as a result of the data entry, posting, and misclassification errors was approximately \$83,000. BFO staff provided a more detailed analysis of the data entry, posting and misclassification errors:

- Account balances for 14 railroad employers were incorrect.

- Contribution rates for three of these 14 employers were adjusted for 1998. Also, one additional employer's rate was adjusted for 1999. As a result, the RRB must refund two employers who had overpaid a total of \$1,525 in 1998 contributions. One employer owes the RRB because it had unpaid \$3,768 in 1998 contributions.

- Contribution rates for 68 new railroad employers were reduced for 1998 and 1999. The RRB must refund a total of \$44,915 to these employees because they overpaid 1998 contributions.

Misclassification of the 15 employers resulted in an impact of \$32,835 on 1998 contributions. Six employers must be refunded a total of \$2,180 and two employers owe the RRB a total amount of \$30,654.

Recommendations:

The Bureau of Fiscal Operations should:

- review compensation and contribution data entered into ECCS and RRXR since January 1990 for accuracy and correct the inaccurate data (Recommendation 4),

- run the ECCS report that identifies possible data entry errors every quarter and investigate all discrepancies (Recommendation 5), and

- reconcile contributions entered in ECCS to contributions posted to BFO's account, prior to the quarterly ECCS upload to RRXR (Recommendation 6).

Management's Response

Bureau of Fiscal Operation's management agreed with all three recommendations. The

Office of Programs and the Bureau of the Actuary have assisted them in reviewing all entries from January 1996 through March 1999. They expect to complete a full analysis by April 2000. In addition, they have recently implemented procedures to run the ECCS report that identifies possible data entry errors and to reconcile contributions entered in ECCS with those posted to BFO's accounts.

BFO's Reconciliation of RUIA Compensation

BFO has not automated the RUIA compensation reconciliation process. BFO conducts an annual reconciliation of RUIA compensation reported to the agency on Form DC-1 with RUIA compensation reported on Form BA-3a, Annual Report of Creditable Compensation. This reconciliation is done manually using paper copies of Form DC-1, information contained in ECCS, and information in the Employment Data Maintenance system (EDM).

Two BFO staff reconcile the RUIA compensation reported by approximately 650 railroads. They start the reconciliation approximately one year after the end of a calendar year and complete it within two years of the end of that year. The statute of limitations for collecting the RUIA contributions is three years.

BFO procedures, written in 1991 and updated in 1993, show that BFO planned to automate the reconciliation process. These planned procedures included an electronic spreadsheet containing compensation information from ECCS and an electronic report containing RUIA compensation information from EDM. These two electronic media were to be combined and the information compared using a personal computer program.

BFO never implemented these 1991 and 1993 procedures. Therefore, the staff continues to perform the reconciliation using labor-intensive manual processing. BFO also performs the reconciliation less timely, which increases the risk that an employer owing additional contributions will not pay the RRB.

Recommendations:

The Bureau of Fiscal Operations should:

- automate the RUIA reconciliation process (Recommendation 7),
- update the procedures to comply with the reconciliation process (Recommendation 8), and
- perform the reconciliation more timely (Recommendation 9).

Management's Response

The Bureau of Fiscal Operation's management has agreed with all three recommendations. They have submitted a request to the Bureau of Information

Services for an estimate to automate the process (Recommendation 7). They have advised that the other two recommendations are dependent on this automation.